



U.S. Department of Justice

*United States Attorney
District of New Hampshire*

*Federal Building
55 Pleasant Street, Room 352
Concord, New Hampshire 03301*

603/225-1552

PRESS RELEASE

FOR IMMEDIATE RELEASE

Wednesday, May 19, 2004

**William E. Morse
Assistant U.S. Attorney
Thomas A. Hanusik
Senior Counsel for Securities Fraud,
Fraud Section
Michael L. Koenig
Trial Attorney, Fraud Section
U.S. Department of Justice
(603) 225-1552**

**FOUR FORMER OFFICIALS OF ENTERASYS NETWORK SYSTEMS, INC.
CHARGED IN ACCOUNTING FRAUD SCHEME**

CONCORD, NEW HAMPSHIRE - Peter E. Papps, Acting United States Attorney for the District of New Hampshire, and Assistant Attorney General Christopher A. Wray of the Criminal Division of the Department of Justice announced that four former executives of Enterasys Network Systems, Inc., have been charged in connection with an accounting fraud at the computer network products company formerly based in Rochester, New Hampshire. One of those officials has pleaded guilty to charges in a separate Criminal Information, and the other three officials are charged in an Indictment handed up by a federal Grand Jury today. The charges in the Indictment stem from an alleged scheme to falsely inflate Enterasys' reported revenue for the purpose of increasing or maintaining the market price of Enterasys stock and the former officials' status and positions within the company. The alleged scheme involved altering and backdating documents, entering into secret side deals and making false and misleading statements in filings with the U.S. Securities and Exchange Commission (SEC), in company press releases and to the company's outside auditors. The Indictment, which contains a total of fifteen counts, charges each of the three former officials, including Enterasys' former Chief Financial Officer, with conspiracy, securities fraud and wire fraud. One of the three former officials is also charged with mail fraud. The Criminal Information to which the other former executive pleaded guilty charges him with one count of wire fraud.

The former officials charged in the Indictment are:

- Robert J. Gagalis, age 49, former Chief Financial Officer and a resident of Rye, New Hampshire.
- Bruce D. Kay, age 53, former Senior Vice President of Finance and a resident of Yarmouth, Maine.
- Gayle Spence, age 45, former Executive Vice President and Assistant to the Chief Executive Officer and a resident of Newfields, New Hampshire.

The former official who pleaded guilty to a Criminal Information is Gary M. Workman, age 57, formerly the President of Enterasys' Asia-Pacific sales division and a resident of San Ramon, California.

Enterasys, a former subsidiary of, and the corporate successor to, Cabletron Systems, Inc., is in the business of designing and selling hardware and software for computer networks. Enterasys' stock is publicly traded on the New York Stock Exchange under the ticker symbol "ETS." Enterasys is now headquartered in Andover, Massachusetts, but was based in Rochester, New Hampshire, at the time of the crimes alleged in the Indictment.

The Indictment alleges that the three former officials and others conspired to and caused Enterasys to fraudulently report that Enterasys had met or exceeded internal revenue projections and Wall Street expectations. One transaction cited in the Indictment is a \$3.5 million agreement Enterasys entered into with a customer known as Ariel International Technologies Co. Ltd. on August 31, 2001, one day before the close of Enterasys' fiscal quarter. The transaction included certain terms, which were reflected in a so-called Letter of Agreement between Enterasys and Ariel, that were not consistent with revenue recognition under relevant accounting principles. Some of the conspirators nonetheless caused Enterasys to record \$3.5 million in net revenue from the transaction.

The Indictment further alleges that, several weeks after the close of the quarter and after learning that Enterasys' outside auditors had selected the Ariel transaction for review, the conspirators allegedly caused the Letter of Agreement to be altered to delete or change the problematic terms. The altered Letter of Agreement was then backdated to create the false impression that it had been executed before the close of the quarter, and a new secret side letter reinstating the deleted terms was issued to Ariel. According to the Indictment, some of the conspirators caused the altered and backdated Letter of Agreement to be sent to the company's outside auditors in connection with their review of Enterasys' quarterly financial statements. Neither the original Letter of Agreement nor the side letter were provided to Enterasys' outside auditors. Some of the conspirators also allegedly caused Enterasys to issue a press release and to make an SEC filing which included the fraudulent revenue and contained related false statements. After the fraud was uncovered, the company restated its earnings and reversed all of the revenue associated with the Ariel transaction.

The Indictment also charges Spence in connection with an additional transaction between Enterasys and SAP AG, a German commercial computer solutions company. According to the Indictment, SAP sought an eighteen month right to exchange \$1 million in computer products it was purchasing from Enterasys in the final days of the quarter ending December 29, 2001. Enterasys allegedly agreed to the right of exchange even though it was not consistent with revenue recognition under relevant accounting principles. The Indictment alleges that Spence and a “very senior” Enterasys official insisted that SAP not refer to the right of exchange in its purchase order, promising instead to put that term in a secret side letter. The Indictment further alleges that Spence then drafted and signed such a side letter and sent it to SAP.

The maximum sentences associated with conspiracy, mail fraud and wire fraud at the time of the offenses was five years per count. The maximum sentence for securities fraud is ten years per count. The offenses also carry with them the possibility of substantial criminal monetary penalties.

This case is being brought under the auspices of the President’s Corporate Fraud Task Force. The investigation was conducted by the Federal Bureau of Investigation and the U.S. Postal Inspection Service and was coordinated with a civil investigation conducted by the SEC’s Central Regional Office in Denver. The case is being prosecuted by Assistant United States Attorney William E. Morse, and, from the Department of Justice’s Criminal Division, Fraud Section, Trial Attorney Michael Koenig and Senior Counsel for Securities Fraud Thomas Hanusik.

Acting United States Attorney Papps reminds the public that an indictment merely alleges that a crime has been committed and that all defendants are presumed innocent until proven guilty beyond a reasonable doubt.